Communications Workers of America
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

August 5, 1998

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

RE: Ex Parte Notice
CC Docket No. 97-211 (Applications of WorldCom and MCI for Transfer of Control of MCI to WorldCom)

Dear Ms. Salas:

On August 5, 1998, the Communications Workers of America submitted the attached written comments to the Policy and Program Planning Division of the Common Carrier Bureau. The written comments provide CWA's response to the Joint MCI WorldCom Ex Parte Filing of July 8, 1998 concerning the merged company's plans in the residential and small business local exchange market.

In accordance to the Commission's rules, I submit two copies of this notice and the written comments.

Sincerely,

George Kohl /dg

George Kohl, Senior Executive Director
Research and Development Department

Attachment

cc: Michelle Carey

No. of Copies rec'd 0+2
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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
Applications of WorldCom, Inc. and	)	
MCI Communications Corporation for	)	CC Docket No. 97-211
Transfer of Control of	)	
MCI Communications Corporation	)	
to WorldCom, Inc.	)	

To: The Commission

Communications Workers of America Response to

Joint Ex Parte Filing by MCI and WorldCom

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Dated: August 5, 1998

Introduction

On July 8, 1998, MCI Communications Corporation (MCI) and WorldCom filed ex parte comments with the Commission in the above-referenced docket.[1] In those ex parte comments, MCI and WorldCom provide Declarations by Mr. Frank Grillo ("Grillo") and Mr. Sunit Patel ("Patel"). Mr. Grillo and Mr. Patel attempt to respond to the evidence provided by the Communications Workers of America (CWA) concerning the negative impact of the merger in the local exchange residential and small business market.[2]

MCI and WorldCom have posited enhanced competition in all segments of the local exchange market as the sole public interest benefit of the proposed merger. But MCI and WorldCom have provided the Commission with no specific business plans or studies to document this claim. MCI and WorldCom have, however, provided shareholders and investors with abundant information to demonstrate that the merged company plans to focus on providing bundled services to business customers to the neglect of local residential customers As WorldCom announced to investors the day it first bid to purchase MCI: "Our Objective Has Not Changed. It is to be the most profitable,

[1] WorldCom, Inc. and MCI Communications Corporation Joint Ex Parte Filing, CC Docket No. 97-211, July 8, 1998.

[2] CWA Comments, Jan. 5, 1998 (as amended Jan. 6, 1998); CWA Reply Comments, Jan. 26, 1998; CWA (Second) Reply Comments, Mar. 20, 1998; CWA Ex Parte Presentation, April 6, 1998; CWA Ex Parte Filing July 2, 1998.

single-source provider of communications services to business around the world."[3] (emphasis added)

Because MCI and WorldCom have never provided concrete documentation to the Commission concerning the merged entity's plans to compete in the residential and small business local exchange market, CWA has focused our analysis on financial and other documents provided by MCI and WorldCom to shareholders and investors. Based on these documents and statements, CWA has demonstrated to the Commission that the merged entity does not plan to invest financial resources in the residential and small business local exchange market.

Commission precedent requires MCI and WorldCom to bear the burden of proof in showing that the proposed merger is in the public interest.[4] MCI and WorldCom have failed to meet this standard. Absent any demonstration of public interest benefit, and with clear demonstration of multiple public interest harm, the Commission should deny the merger request. In the alternative, the Commission should ensure that it has resolved each of the public interest concerns.

CWA suggests one mechanism that the Commission could adopt to address the negative impact the merger will have on the residential and small business market in the local exchange. CWA suggests that the Commission require the merged entity to contribute a portion of the

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[3] WorldCom, Proxy Statement filed with the SEC Pursuant to Section 14(a), Amendment No. 1, Oct. 9, 1997, 5 (http://www.sec.gov/Archives/edgar/data/64079/0001047469-97-000296.txt).

[4] Bell Atlantic/NYNEX Order, File No. NSD-L-96-10, Aug. 14, 1997. *See* also CWA Comments, Jan. 5, 1998 (as amended Jan. 6, 1998) ; CWA Reply Comments, Jan. 26, 1998; CWA (Second) Reply Comments, Mar. 20, 1998; CWA Ex Parte Presentation, April 6, 1998.

merger-related efficiency savings to a fund which would support discounts to schools, libraries, and rural health care providers as part of the Commission's universal service program. This remedy would also offset the negative impact the merger will have by reducing actual and potential competition in the local exchange residential and small business market and by redlining minority neighborhoods.

We provide a more detailed critique of Mr. Grillo's and Mr. Patel's declarations below. But first, we provide a brief summary of the public interest harm that would result from this proposed merger. The Commission must address each of these issues.

I. The Commission Must Address The Public Interest Harm that Would Result from the Proposed MCI-WorldCom Merger

1. The merger would reduce competition in the local exchange market. As noted above, MCI and WorldCom fail to prove their assertion that the merger will enhance competition in the residential and small business local exchange market. They fail to explain how a cut of $5.3 billion in the local exchange over the next four years and a reduction by one of competing networks in 22 urban centers in 17 states will enhance local competition.[5] As recently as Aug. 3, 1998 WorldCom's Chief Financial Officer Scott D. Sullivan stated to potential investors:

[5] CWA Comments, Jan. 5, 1998 (as amended Jan. 6, 1998); CWA Reply Comments, Jan. 26, 1998; CWA (Second) Reply Comments, March 20, 1998.

> (T)his transaction (the MCI-WorldCom merger), allows us to save roughly $400 million of MCI annual start-up cost...They are in the start-up mode with MCI-Metro right now looking to build everywhere that MFS and WorldCom have built over the last twelve years...MCI is looking to build in the same cities...You see MCI brought down their capital plans in 1998 from $3.9 billion to $3 billion. They've accumulated nearly $1 billion in cash in the last two quarters of operation and that's from reduced spending in the local area. (emphasis added)[6]

As we detail below, MCI and WorldCom fail to refute CWA's financial analysis that demonstrates that the high levels of goodwill and increased debt stemming from the merger will require the merged entity to abandon MCI's plans to compete in the low-margin residential local exchange market.

2. MCI and WorldCom's networks redline minority residential and small business consumers. The Rainbow/PUSH Coalition has provided the Commission with maps of MCI's and WorldCom's local networks in five metropolitan areas (Los Angeles, San Francisco, New York City, Chicago, and Atlanta).[7] In each of these major urban centers, MCI's and WorldCom's local networks bypass minority residential consumers and small businesses. Whether the redlining is economic or racial, MCI and WorldCom fail to provide the Commission with any evidence of future build-out plans designed to serve these underserved communities

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[6] Statement by Scott D. Sullivan, WorldCom Chief Financial Officer, Investor Road Show, New York City, Aug. 3, 1998.

[7] Rainbow/Push Coalition and the Greenlining Institute, et al., Ex Parte Presentation on Redlining, June 3, 1998.

3. The merger will arbitrage public subsidies used to ensure the provision of quality, affordable telecommunications services and promote the deployment of advanced telecommunications services to all Americans. The merged entity will gain competitive advantage in the business market by arbitraging public subsidies used to support ubiquitous public networks and to provide quality, affordable local residential service.

The merged entity anticipates savings from avoided access charges of $2.5 billion in the first four years after the merger. According to data provided by MCI and WorldCom to investors, the merged entity anticipates savings from avoided access charges of $200-$250 million in 1999, rising to $1 billion in 2002.[8] Interpolating for the intervening years, the merged company anticipates savings from avoided access charges of $500 million in 2000 and $750 million in 2001, totaling $2.5 billion in avoided access charges over the four year period. (*See* Attachment)

To ensure that the merger does not harm the provision of high-quality, affordable residential service over ubiquitous public networks, CWA recommends as a possible remedy that the Commission require the merged MCI-WorldCom contribute a dedicated portion of the efficiency savings resulting from this merger into a fund which would be used to supplement discounts provided to schools, libraries, and rural health centers as part of the Commission's universal service program. This remedy would offset the negative impact the merger will have in the

[8] MCI WorldCom Analyst Conference Call Merger Announcement, Nov. 10, 1997, 7. (Note that the avoided access charge cost-savings that we cite here are the "revised" synergy savings as announced by WorldCom and MCI. The avoided access charge cost savings cited in our earlier Jan. 26. 1998 Reply Comments were based on earlier announced "previous" synergy estimates.)

residential and small business local exchange market caused by reduced actual and potential competition, arbitraging public subsidies, and redlining minority neighborhoods.

4. The merger would result in substantial job loss. The Commission must also consider the impact on employment that would result from a proposed merger as part of its public interest review. In anticipation of the merger, MCI has announced plans to lay-off 4,500 employees.[9] To realize the draconian synergy savings that MCI and WorldCom have announced, we conservatively estimate the merged company will lay-off a total of 10,000 employees in the four years immediately following the merger.[10] These are actual job cuts that would result from the merger.

In addition, CWA has estimated that the merger would also negatively impact employment through a reduction of 75,000 telecommunications jobs that would have been created by year 2002 absent the merger's drastic cutting in both capital and operating expenses.[11]

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[9] MCI, SEC Form 10-K for fiscal year 1997, 115.

[10] We calculate the 10,000 lay-offs as follows. According to a Merrill Lynch analysis, the combined company's Sales, General, and Administrative (SG&A) expenses will be $10.8 billion in year 2002 (Merrill Lynch, WorldCom, Inc., Feb. 4, 1998). WorldCom-MCI have announced they plan to cut $1.3 billion in SG&A savings in 2002 (Analyst Conference Call, Nov. 10, 1997, 8. See also SEC Form S-4, Amendment No. 3, Jan. 22, 1998 attached to MCI WorldCom Joint Reply Comments, Jan. 26, 1998, Attachment G,). We divide the $1.3 billion SG&A cuts by the $10.8 billion pre-merger pro-forma SG&A expense = 11.9 percent cut in SG&A expenses. MCI and WorldCom's total employment today is 80,809 (MCI and WorldCom SEC Form 10-K, 1997). We multiply 80,809 employees x 11.9 percent cut = 9,616 lay-offs. We have rounded to 10,000 employees.

[11] CWA Comments, Jan. 5, 1998 (as amended Jan. 6, 1998); CWA Reply Comments, Jan. 26, 1998; CWA Second Reply Comments, Mar. 20, 1998.

5. The merger would reduce competition in the long distance market. CWA concurs with GTE and other commentators that the merger will have a negative impact in the wholesale long distance market by eliminating the "maverick" WorldCom.

6. Absent strengthened safeguards, the merger will harm competition in the Internet market. Absent an oversight mechanism and policies requiring open, nondiscriminatory peering policies and data collection on traffic flow on the Internet, the Commission cannot be assured that MCI's divested Internet customers will not backslide to MCI.[12] Free flow of information is a necessary pre-condition for a competitive market.

In sum, CWA and other commentators have adequately demonstrated significant public interest harm that would result from the proposed merger of MCI and WorldCom. The Commission must adequately address each of these issues to meet its statutory obligations to ensure that a merger is in the public interest. Alterntively, the Commission should deny the Applicants' merger request.

II. CWA Response to Declarations of Frank Grillo and Sunit Patel

MCI and WorldCom, through the Declarations of Frank Grillo and Sunit Patel, once again fail to refute evidence provided by CWA that the merged entity will not compete in the local exchange residential and small business market.

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[12] CWA Ex Parte Comments on MCI's Internet Divestiture, July 24, 1998.

A. Grillo Declaration Demonstrates that a Merged MCI-WorldCom Will Adopt a Strategy Focused on the Business Market

Mr. Grillo's discussion makes clear that the merger will add shareholder value because it will facilitate bundling of local, long distance, Internet, and other services to two distinct business markets: medium- and large-sized business customers. Mr. Grillo notes that WorldCom has historically positioned itself to serve "lower to mid-range business customers" (Grillo, 3) while MCI has served the "high-end and large business customer segments" (Grillo, 5).

Mr. Grillo further explains another rationale for the merger. The merger will combine "the facilities-based presence of WorldCom with the customer base and marketing savvy of MCI." (Grillo, 5). Since WorldCom's local facilities-based network serves only business customers in urban markets, Mr. Grillo's statement actually supports CWA's basic point: the merged entity plans to compete in the local exchange solely for business customers. WorldCom's facilities do not serve local residential customers. In fact, Mr. Grillo points out in his declaration that WorldCom has specifically chosen not to market to residential end-users because of this market's "high acquistion cost" (Grillo, 4). We could not have said it better than WorldCom's Vice-President of Marketing, Frank Grillo.

Mr. Grillo notes that "one result of combining the networks of MCI and WorldCom will be the improved ability to provide one-network service to multi-location customers" (Grillo, 6).

Multi-location customers are by definition not residential or small business customers. Mr. Grillo affirms that the merged MCI-WorldCom's strategy is to be "the most profitable, single-source provider of communications services to business around the world."[13] (emphasis added)

B. Declaration of Sunit Patel Fails to Refute the Public Interest Implications of CWA's Financial Analysis

Mr. Patel's response to CWA's financial analysis is based on the faulty assumption that the purpose of CWA's analysis was to determine whether the merger would increase shareholder value. As we stated in the introduction to the analysis, the purpose was to assist the Commission in determining whether the proposed merger is in the public interest.

Using standard financial analysis, CWA examined the business strategy dictated by the financial structure of the merged MCI-WorldCom. Based on this analysis, CWA concluded that the merged MCI-WorldCom will be under tremendous financial pressure to pursue high-margin returns because of the high-level of goodwill on its books and the increased debt load stemming from the merger. When a company pays far above book value and records the premium as goodwill, the expectation is that the buyer will be able to recoup the premium by pursuing a business strategy that will ensure superior or extra-historical levels of future profits. In sum,

[13] WorldCom, Proxy Statement Filed with the SEC Pursuant to Section 14(a), *op cit.*, 5.

CWA concluded that the financial imperatives of the merger will require MCI-WorldCom to abandon the pursuit of low-margin residential customers.[14]

We respond in detail first to Mr. Patel's critique of CWA's data and methodology and second to his critique of the financial ratio analysis.

Data and Methodology

Mr. Patel claims that the financial data that we have used is problematic because we applied post-merger synergy estimates to prior year statistical results (Patel, 1). CWA relied on the very same pro-forma analysis covering the exact same time period (the first nine months of 1997) that MCI and WorldCom supplied to its shareholders while seeking merger approval. (A pro-forma analysis literally means "as if they were already together.") This pro-forma balance sheet and income statement are on pages 89 and 90 of the Joint Proxy Statement/Prospectus dated January 22, 1998.[15]

CWA used the most conservative method available to account for the impact of the "Revised Estimated Synergies" as reported by MCI and WorldCom. We assumed that the synergies posited by MCI and WorldCom in the Joint Proxy Statement/Prospectus were in fact achievable

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[14] CWA (Second) Reply Comments, Mar. 20, 1998; CWA Ex Parte Presentation, April 7, 1998; CWA Ex Parte ("Taking MCI Out of Local Competition"), July 2, 1998.

[15] Also referenced as SEC Form S-4, Amendment No. 3. Jan. 22, 1998, MCI and WorldCom Reply Comments, Attachment G, Jan. 26, 1998.

in the first year of the merger. We then applied these Revised Estimated Synergies to the pro-forma analysis provided by MCI and WorldCom.

Mr. Patel also claims that CWA's analysis should be discredited because we did not include anticipated revenue growth (Patel 2). We did not include revenue projections for the simple reason that MCI and WorldCom have never forecast any revenue synergies resulting from the merger in any documents provided to shareholders or to the Securities and Exchange Commission. The finances of the merger, as presented to shareholders and reported to the SEC, are based purely on cost cutting or "cost synergies." The impact of the Brooks Fiber, ANS, and CNS acquisitions which Mr. Patel claims is significant also was not provided to shareholders or regulators, and therefore this information is not available for comment.

Furthermore, CWA was interested in preserving the integrity of the pro-forma financial statements used in its analysis. Had CWA forecast revenue growth, it would also have had to forecast changes in cost of materials, asset depreciation, inflation, interest rates, etc., in an effort to generate values for the other line items contained in the pro-forma balance sheet and income statement.

In sum, CWA conducted its analysis based on the most recent publicly available pro-forma financial data contained in documents provided to the Securities and Exchange Commission. MCI and WorldCom are bound by law to provide accurate data to shareholders and to the SEC.

Financial Ratio Analysis

Mr. Patel asserts that CWA claims that "WorldCom is paying an unreasonable premium for MCI" (Patel, 1). As noted earlier, CWA's analysis does not seek to determine whether WorldCom is paying a fair price for MCI from an investment perspective. Rather, our purpose was to determine the business strategy of the combined entity, based on its financial structure. Thus, the relevant universe for comparison was the one that we used--major telecommunications companies, and not, as Mr. Patel asserts, the S&P 500.

Mr. Patel also claims that investment analysts uniformly disagree with CWA's analysis of Asset Productivity and Income Generating Capacity Ratios (Patel, 2). CWA found that the merged MCI-WorldCom will make less efficient use of MCI's assets, due largely to the large increase in intangible assets on the merged entity's books. We have reviewed many investment analyst reports and, contrary to Mr. Patel's assertion, we find that they have been silent on this measurement.

Mr. Patel also challenges CWA's use of a 52 percent effective tax rate (Patel, 2). CWA took this figure directly from WorldCom's 1997 SEC Form 10-K.[16] We hope that WorldCom and MCI

[16] WorldCom explains in its 1997 SEC Form 10-K that "the effective income tax rate for 1997 was 52 percent before taxes. The 1997 rate of 52 percent is greater than the expected statutory rate of 35 percent primarily due to the fact that amortization of the goodwill related to the MFS Merger is not deductible for tax purposes." The Internal Revenue Service has ruled that WorldCom must use the same purchase accounting method to account for its purchase of MCI. Purchase accounting does not allow for the deduction of goodwill amortization for tax purposes. Thus, CWA relied on WorldCom's stated 1997 effective tax rate as disclosed to the SEC. (WorldCom SEC Form 10-K, 1997, 24.)

are not as disingenuous in their reporting of other financial statistics as they were in denying their own report of a 52 percent effective tax rate.

Mr. Patel also incorrectly interprets CWA's discussion on liquidity (Patel, 3). CWA makes no claim that MCI-WorldCom's "ability to obtain additional funding will be constrained." CWA has no doubt that MCI-WorldCom, or for that matter, other major telecommunications companies, have the ability to raise capital for expansion in the present economic environment. CWA's point is that the combined MCI-WorldCom's increased debt load and more highly leveraged position will make raising future capital more expensive which in turn will require MCI-WorldCom to make capital expenditures that will generate higher returns. This implicit financial imperative will preclude MCI-WorldCom from building networks to serve residential consumers.

Mr. Patel writes that the combined MCI-WorldCom will have an S&P indicative rating of BBB-, with a positive outlook and a Moody's Baa2 rating (Patel, 4). CWA would like the Commission to note that MCI had a higher credit rating on a stand-alone basis of A2 (Moody's) and A/A-1 (S&P) prior to the merger announcement.[17] Therefore, the merger *does* have a negative impact on MCI's credit rating.

Finally, Mr. Patel concludes that "the merger contemplated by WorldCom and MCI will create a stronger more financially viable competitor able to use its resources in an efficient and

[17] Dow Jones Newswires, "WorldCom/MCI/Moody's-2; MCI Downgraded, Rating Parity," April 16, 1998; S&P Press Release, July 31, 1998 (http://biz.yahoo.com/finance/980731/s_p_ups_wo_1.html)

constructive manner." (Patel, 4) Mr. Patel fails to refute the main point of CWA's analysis which demonstrates that the financial structure of the merged MCI-WorldCom will pre-empt their ability to put their resources (efficiently or inefficiently) into lines of business where the returns are lower, i.e. the residential local exchange market.

Sincerely,

By George Kohl /ol
George Kohl
Senior Executive Director, Research and Development

August 5, 1998

MCI WORLDCOM
Analyst Conference Call
Merger Announcement
November 10, 1997

WorldCom
Investor Relations
Gary Brandt
601-360-8544

Line Cost Synergies

With respect to line cost synergies, I'll describe four main areas of line cost savings in 1999, the expected first year of savings. Then I'll walk forward a few years and discuss what we believe we will achieve in the year 2002.

Line cost savings are greater than originally anticipated. The first item is a reduction in the originating line costs related to dedicated access lines for existing and new MCI large customers. We anticipate savings of $200 million to $300 million in 1999 and about $600 million in 2002.

The second item is switched access cost savings for MCI's existing and new accounts. These are the small and medium sized customers. We expect $200 to $250 million dollars in savings in 1999 and this on a perspective basis, is not related to the existing customer base. These savings come from sales onto the new local facilities of the combined new entity. We expect these savings to ramp up to over $1 billion in the year 2002.

The third expected reduction is domestic variable line costs, specifically watts costs, which is in a range of $90 to $100 million dollars in 1999, growing to $100 to $150 million in the year 2002.

The fourth line cost savings is in international terminations. On traffic that originates from the United States and terminates worldwide, we had previously been very conservative and the new estimates prove that out. We now expect savings of $300 to $400 million in the first full year of operation in 1999, growing to $1.2 billion to $1.3 billion in the year 2002.

MCI has a much greater number of direct operating agreements with foreign correspondents and WorldCom has facilities, specifically Trans-Atlantic facilities and Pan-European facilities that are now under construction. With MCI's cooperation, this synergy number firmed up considerably.

In summary, in the line cost area, we expect to have $850 million to $1.1 billion in savings in the first year, growing to between $2.9 and $3.2 billion just in the line cost area by the year 2002.

MCI Metro Local Cost Savings

With respect to MCI Metro local cost savings, the second main area of savings, we fully expect to avoid MCI Metro local startup expenses, both in SG&A and in network costs. What we're looking to achieve is to bring the level of MCI Metro profitability to the level of expectations before the second quarter pre-announcement. These improvements will come from some of the activities that MCI has initiated on their local side, while other benefits will come from where WorldCom facilities and systems are today. We're looking to achieve savings in the area of $500 million in the first year of operation, grown to about $1.2 billion in the year 2002.

This figure is a little more conservative than that provided back on October 1 due to a differing mix in local revenue components following the joint review.

SG&A Savings

With respect to core selling, general and administrative expenses, we expect savings primarily in three areas. MCI management agreed with our estimates and these savings roughly put MCI back on a spending parity in relationship to revenue with other telecom players such as AT&T.

We expect efficiencies in the network operations related to facilities, but not a lot of cost savings related to people cost. One thing I want to emphasize on this call is that we have the ability to hit every SG&A number that we've put out and still add 10,000 people in the next 18 to 24 months. This is about adding people, but adding people at a lower rate than the rate-of-revenue growth that we have as a combined company.

We expect reductions in the combined companies' corporate overhead in an area of $400 to $500 million in the first year of operation.

So in summary, in 1999, what we're looking for is between $900 million to $1 billion in SG&A savings, growing to $1.2 billion to $1.3 billion in the year 2002. Most of these savings will come in the form of reduced growth in expenditures rather than cutbacks as I said. In fact, we expect MCI WorldCom will add up to 10,000 new positions.

Non-Cash Operating Savings

In non-cash operating savings, we also expect reductions in depreciation in a range of $100 to $200 million in 1999 growing to $450 million to $550 million in the year 2002. This cut comes from reductions on the capital expenditure side, primarily in the areas that I mentioned: long-haul domestic and international, local network and information technology.

Capital expenditure savings

We expect long-haul to have an annual capital expenditure savings starting in the first year of operations of over $750 million in the local sector and about $400 million in the information technology spending. The total capital expenditure savings is about $2 billion annually, beginning in 1999. Again, these numbers do not include potential revenue benefits from the combined operations.

Earnings-per-share accretion

The earnings-per-share accretion is at least 20%. The MCI ownership of the combined company is approximately 45% vs. the 25% ownership that MCI would have had in a BT transaction.